

EXECUTIVE SECRETARIAT

Routing Slip

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Remarks:

NSC review completed.

Executive Secretary
10/27/82
Date

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THE WHITE HOUSE
WASHINGTON

Executive Registry

82-12729

CABINET AFFAIRS STAFFING MEMORANDUMDATE: 10-25-82 NUMBER: ----- DUE BY: -----

SUBJECT: Cabinet Council Minutes

	ACTION	FYI		ACTION	FYI
ALL CABINET MEMBERS	<input type="checkbox"/>	<input checked="" type="checkbox"/>	Baker	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Vice President	<input type="checkbox"/>	<input type="checkbox"/>	Deaver	<input type="checkbox"/>	<input type="checkbox"/>
State	<input type="checkbox"/>	<input type="checkbox"/>	Clark	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Treasury	<input type="checkbox"/>	<input type="checkbox"/>	Darman (<i>For WH Staffing</i>)	<input checked="" type="checkbox"/>	<input type="checkbox"/>
Defense	<input type="checkbox"/>	<input type="checkbox"/>	Harper	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Attorney General	<input type="checkbox"/>	<input type="checkbox"/>	Jenkins	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Interior	<input type="checkbox"/>	<input type="checkbox"/>	Wheeler	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Agriculture	<input type="checkbox"/>	<input type="checkbox"/>	Kudlow	<input type="checkbox"/>	<input checked="" type="checkbox"/>
Commerce	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Labor	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input checked="" type="checkbox"/>
HHS	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
HUD	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Transportation	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Energy	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Education	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
Counselor	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
OMB	<input type="checkbox"/>	<input type="checkbox"/>		<input type="checkbox"/>	<input type="checkbox"/>
CIA	<input type="checkbox"/>	<input type="checkbox"/>	CCCT/Gunn	<input type="checkbox"/>	<input checked="" type="checkbox"/>
UN	<input type="checkbox"/>	<input type="checkbox"/>	CCEA/Porter	<input type="checkbox"/>	<input checked="" type="checkbox"/>
USTR	<input type="checkbox"/>	<input type="checkbox"/>	CCFA/Boggs	<input type="checkbox"/>	<input checked="" type="checkbox"/>
CEA	<input type="checkbox"/>	<input checked="" type="checkbox"/>	CCHR/Carleson	<input type="checkbox"/>	<input checked="" type="checkbox"/>
CEQ	<input type="checkbox"/>	<input type="checkbox"/>	CCLP/Uhlmann	<input type="checkbox"/>	<input checked="" type="checkbox"/>
OSTP	<input type="checkbox"/>	<input type="checkbox"/>	CCMA/Bledsoe	<input type="checkbox"/>	<input checked="" type="checkbox"/>
	<input type="checkbox"/>	<input type="checkbox"/>	CCNRE/Boggs	<input type="checkbox"/>	<input type="checkbox"/>

REMARKS: Attached for your information are the minutes of the September 29 and October 8 meetings of the Cabinet Council on Economic Affairs and the September 29 meeting of the Cabinet Council on Commerce and Trade.

RETURN TO:

Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823

Becky Norton Dunlop
Director, Office of
Cabinet Affairs
456-2800

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

September 23, 1982
2:00 p.m.
Cabinet Room

Attendees: The President, The Vice President, Messrs. Regan, Weinberger, Smith, Watt, Baldridge, Pierce, Lewis, Edwards, Meese, Stockman, Feldstein, Harper, Darman, Fuller, Gergen, Williamson, Porter, Dam, Lyng, Macdonald, Chapoton, Poole, Angrisani, Cribb, Jenkins, Duberstein, Garrett, Nau, Caveney, and Ms. Dunlop.

1. Review of the Economic Outlook

Martin Feldstein presented a review of the economic outlook in the context of four basic structural problems facing the economy in recent years: high inflation, low capital formation, increasing taxation and government spending, and a high level of structural unemployment.

He noted that the primary cause of increasing inflation has been excess demand fueled by a reckless pursuit of lower unemployment based on a Keynesian misdiagnosis of the nature of modern unemployment, inappropriate monetary policy, and inflation expectations built into wage agreements.

He also reviewed our capital formation performance and the near-term and longer term prospects, patterns in federal taxing and spending, and the dimensions of our structural unemployment problem. He reiterated that the President's Economic Recovery Program is sound and will address these four basic structural problems, but that achieving our objectives will not come easily, painlessly, or rapidly.

He noted that this was an unusual recovery coming at the end of the largest postwar disinflation and that it was very important to prevent a rekindling of inflation. While the timing of the recovery is uncertain he indicated that several key economic indicators suggest it may soon begin: a rise in the leading indicators for four consecutive months, an easing in monetary conditions, and Commerce estimates of real GNP up for two quarters. But he also cautioned that virtually all of the monthly figures indicate that the recovery did not begin by August.

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The discussion focused on the prospects for housing during the coming months, the treatment of social security in the budget, and the likely strength of the recovery.

2. Flat Tax

Secretary Regan reported that Assistant Secretary John E. Chapoton would testify on the flat tax before the Senate Finance Committee on Tuesday, September 28. In his testimony he will not present an administration flat tax proposal or an administration position on any congressional flat tax proposals. Instead, he will discuss many of the advantages and difficulties inherent in genuinely uniform flat tax plans. His testimony will also identify some of the difficult decisions that would be required to reform our tax structure into a uniform system that provides consistent treatment across the board.

Secretary Regan noted that flat tax proposals generally have two elements: a reduction in the number of tax brackets to a single rate and the elimination of numerous deductions, credits, and exemptions to achieve a low rate. He observed that relying on a single rate would have significant redistributive effects lowering the tax burden for high-income individuals and families while increasing it for many low and middle-income individuals.

Eliminating deductions, exemptions, and credits would almost certainly generate much controversy. Fringe benefits, government transfer payments, and currently exempted interest income on state and local bonds are examples of income exempt from Federal tax that would lose this status under a comprehensive flat tax proposal. Moreover, a consistent flat tax proposal would eliminate the double taxation of corporate income.

Secretary Regan noted that the draft testimony contains two basic models for a comprehensive flat tax: a uniform income tax and a uniform tax on consumed income. The major difference between the two is that a uniform tax on consumed income would not tax savings. These two structures are similar in that they tax all sources of income equally and do not discriminate for or against certain industries or types of investment.

The discussion focused on the fairness of the current tax system, the rate at which a flat tax would need to be set in order to generate the same revenue stream as occurs

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under the current progressive tax schedule, possible ways of simplifying the tax system, and the political obstacles to comprehensive tax reform.

The President approved the Cabinet Council recommendation that the Treasury testimony not endorse or oppose the flat tax or either of the two basic models for a comprehensive flat tax but emphasize the need to continue to pursue tax policies, as those already proposed by the Administration, that create an environment for savings, investment and economic growth.

3. Job Training Legislation

The Council briefly discussed the major elements in the job training legislation just completed by a joint Senate-House Conference Committee and the extent to which it conforms to the principles approved by the President following the February 11, 1982 CCEA meeting.

The President approved issuing a statement later today calling on the Congress to swiftly enact the new job training bill and emphasizing that the principles considered essential by the administration form the core of the legislation.

MINUTES
CABINET COUNCIL ON ECONOMIC AFFAIRS

October 8, 1982
11:00 a.m.
Roosevelt Room

Attendees: Messrs. Regan, Donovan, Stockman, Pierce, Porter, Lyng, Fiske, Trent, Davis, Wallis, Poole, Sprinkel, Kudlow, Caveney, Cicconi, Platt, Bailey, Whitfield, Kabel, Neal, Denend, and Ms. Dunlop.

1. Review of the Unemployment Situation

The Council reviewed the unemployment situation in light of the unemployment rate of 10.1 percent announced for September this morning. Secretary Regan circulated the press release which formed the basis of his press conference earlier in the morning. He reported that there were initial questions on the rate of unemployment but the questions quickly shifted to the overall economy and the Administration's program for recovery.

Secretary Donovan reported on the specific statistics underlying the overall unemployment rate for September. He noted that the raw unemployment rate was adjusted downward for seasonal reasons. Also, the new Federal Supplemental Benefit Program which extends unemployment insurance benefits for up to ten additional weeks as a part of the Tax Equity and Fiscal Responsibility Act probably caused some workers to reenter the labor force during September in order to receive additional benefits. This factor could have accounted for an increase of approximately 0.1 percent in the adjusted unemployment rate.

2. Financial Market Developments

The Council reviewed three papers prepared by Beryl Sprinkel, William Poole, and Larry Kudlow on various issues related to recent financial market developments.

Mr. Sprinkel noted that it is important to distinguish between the short term and long term effects of monetary policy. In the long term, the rate of growth of the money supply affects the price level and interest rates through expectations about inflation. In the short term, the rate of growth of the money supply affects economic activity, but it is not possible to sustain real economic growth through an inflationary monetary policy.

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He observed that the Administration's goal has been to move gradually from an inflationary monetary policy to one characterized by moderate and steady growth. The transition to a noninflationary monetary policy has been abrupt --- the result more of an inherent inability to control precisely the money supply than a conscious decision to sharply reduce its rate of growth. He also noted that two developments -- the maturing of the all-savers certificates and the introduction of the new DIDC-created financial instrument -- promise to make the task of controlling monetary aggregates even more difficult.

Mr. Sprinkel suggested that it is extremely important to separate the short term conditions of unemployment and recession associated with the transition from an inflationary economy from our long term objective of sustained economic growth without inflation. The transition is necessary but should not deter us from our long term goal.

Mr. Poole summarized his paper, observing that events of this past week are instructive in understanding the effect of expectations on market behavior. Information about the Federal Open Market Committee decisions to ease monetary policy has produced a dramatic stock market rally and reduction in interest rates. This development is understandably good news for the short run but does not augur well for the long run. It suggests that the Federal Reserve Board has adopted a short run view of policy and calls into question the Board's commitment to its monetary growth targets.

At this point, he claimed, there is no clear understanding about intended policy between the Federal Reserve Board and the financial markets. The events of this week have not helped. What is needed is leadership on the part of the Board. It is important for the Fed to demonstrate its commitment to longer term growth targets. The exact level and the control mechanism are less important at this moment. He added that if the events of this week lead to excessive monetary growth, the choices six months from now will not be attractive: abandon the growth targets all together, or restrict monetary growth severely which would have a devastating effect on the recovery.

Mr. Kudlow reviewed his paper, stressing that the market related events of this past week signal dramatic changes in expectations and are a vote of confidence for the Administration's policies. He noted the correlation between the reduction in interest rates over the past several months and

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Presidential policy announcements and key Congressional votes during that period. The lower interest rates reflect reduced expectations about inflation as a result of increased confidence in the performance of government.

Other encouraging signs include an effort by firms to reduce their short term borrowing needs and to improve their balance sheets, relatively stable commodity prices, and continued confidence in the dollar based on confidence in the future of the U.S. economy. Uncertainty about the future in the financial markets stems for the most part from the steadily increasing Treasury financing requirements. The Federal government will continue to absorb a considerable portion of the savings pool, making it unavailable for private investment.

The Council discussed monetary policy and its effects on the financial markets. There was a question as to whether the Federal Reserve Board had consciously accelerated its reduction in the rate of growth of the money supply. The Council reviewed the importance of retaining a monetary policy tied to growth in money aggregates, even though the aggregates will change as the composition of monetary assets changes and new assets are created. The Council noted the difference between a policy to control money growth through a commitment to growth targets and how well the policy is being executed. The Council generally agreed that the Federal Reserve Board's credibility has improved in recent months.

The Chairman Pro Tempore directed the Executive Secretary of the Council to develop a paper for the President blending the themes of the three papers reviewed today.